



**Life Cycle Cost Analysis; Large Cabin
Class Aircraft Values – Current Trends;
Federal Excise Tax Tips for the
Unwary**

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Current Aircraft Market Trends

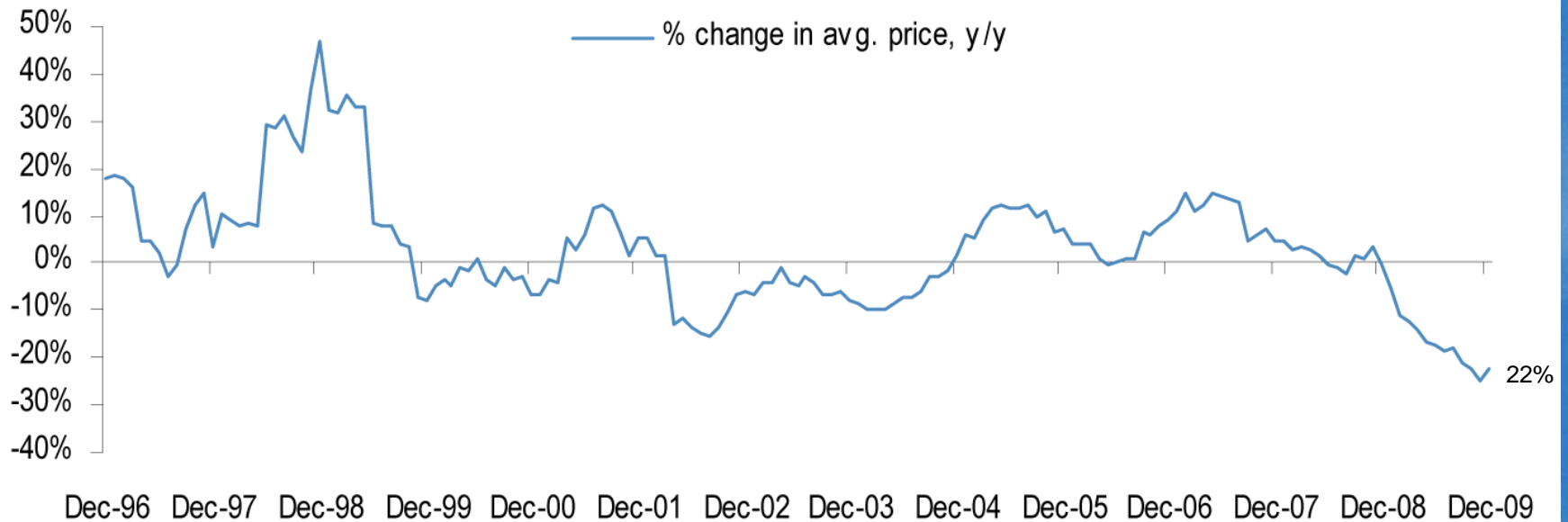
Used Jet Inventories

- Defined – jets for sale as a proportion of the active fleet
- Inventories decreased to 12.8% in December from 13.2% in November
- Average asking prices down nearly 22% year to year
 - Light jets down 1.1% from November to December
 - Medium jets up 0.2% from November to December
 - Heavy jets up 0.1% from November to December



Change in Avg. Asking Price (all aircraft)

Figure 23: % Change in Average Asking Price

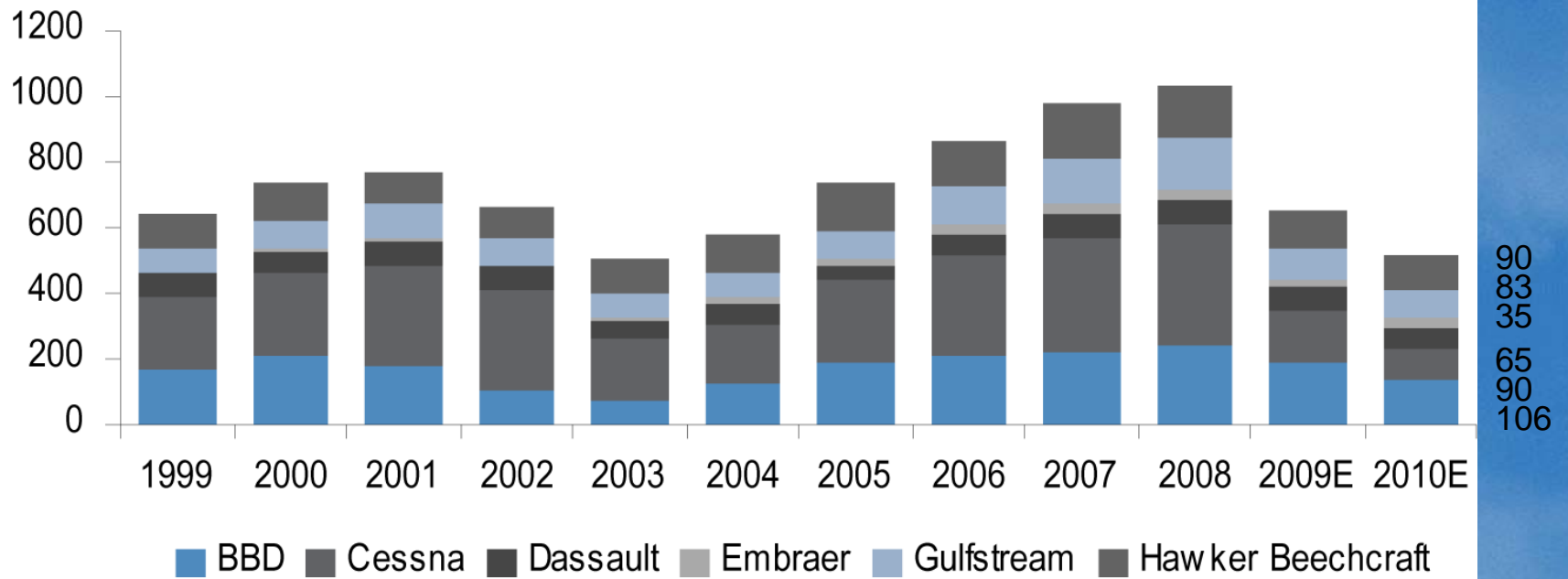


Source: JetNet, J.P. Morgan estimates.



Deliveries 1999-2010E

Figure 8: Industry Deliveries by Company, 1999-2010E

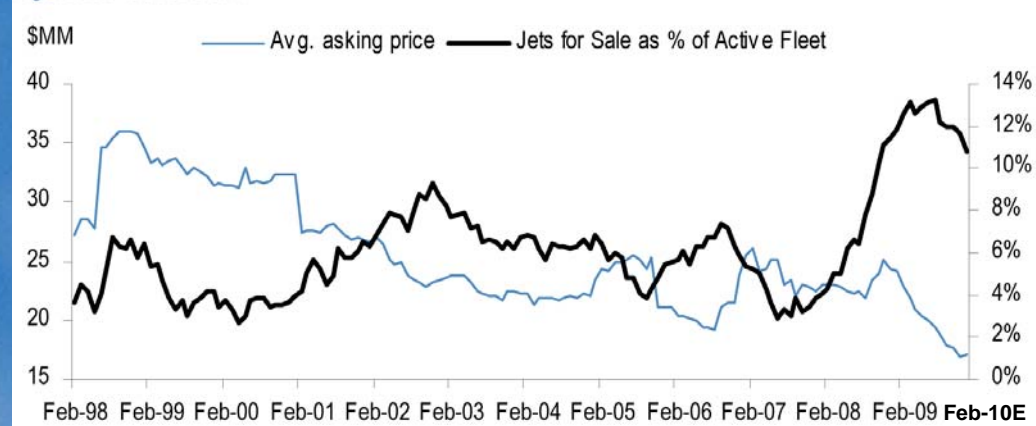


Source: Company data, GAMA. Note: Excludes VLJs.



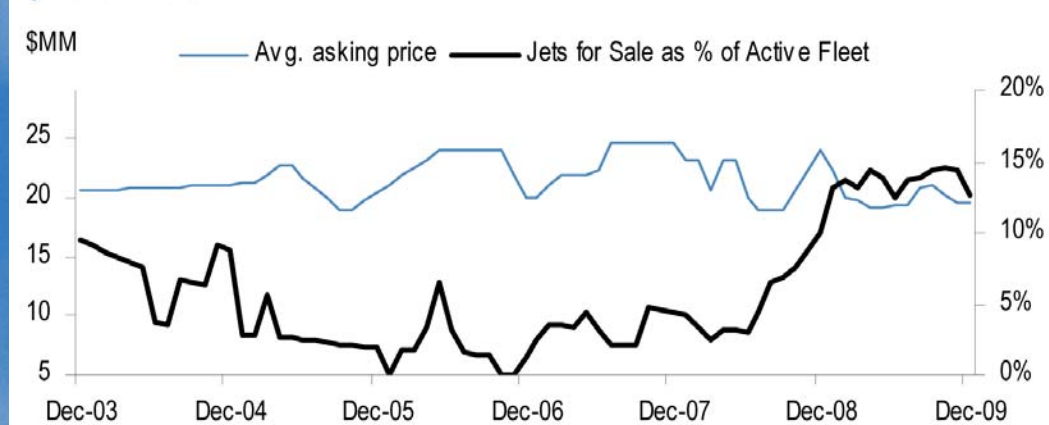
Gulfstream and Embraer

Figure 28: Gulfstream



Source: Jetnet and J.P. Morgan estimates.

Figure 29: Embraer

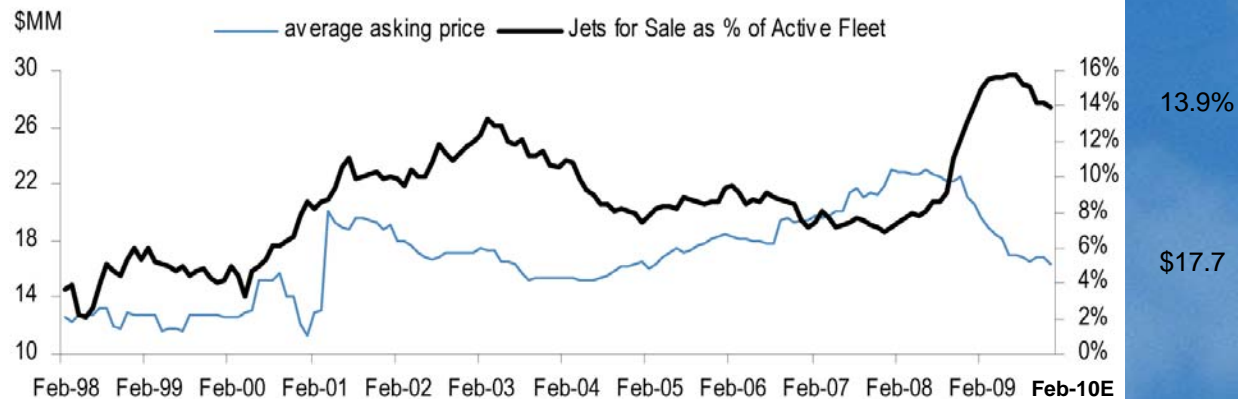


Source: Jetnet and J.P. Morgan estimates.



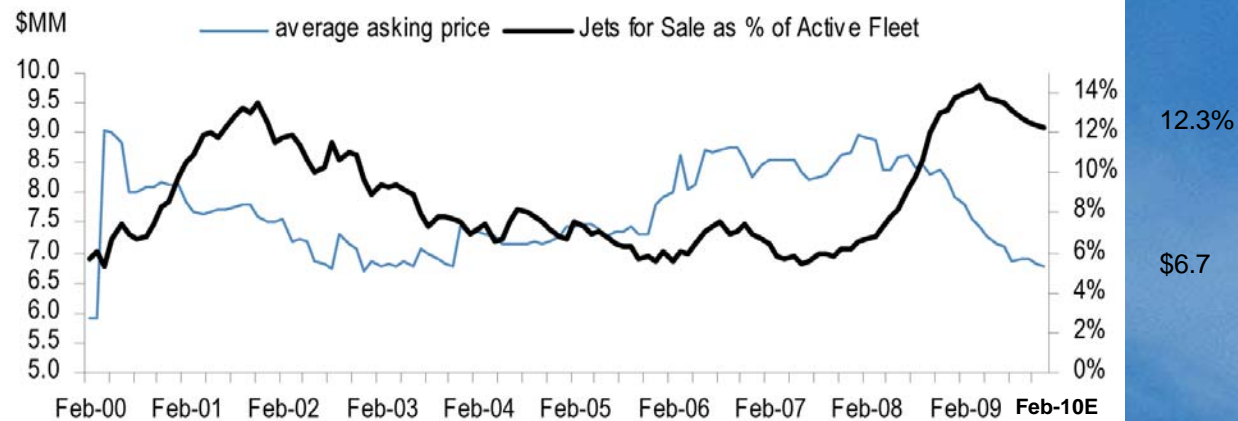
Bombardier and Cessna

Figure 24: Bombardier



Source: Jetnet and J.P. Morgan estimates.

Figure 25: Cessna

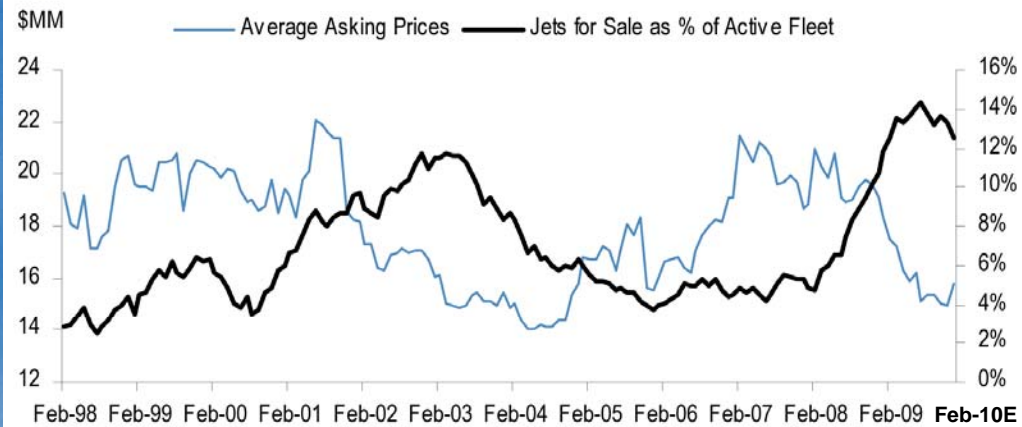


Source: Jetnet and J.P. Morgan estimates.



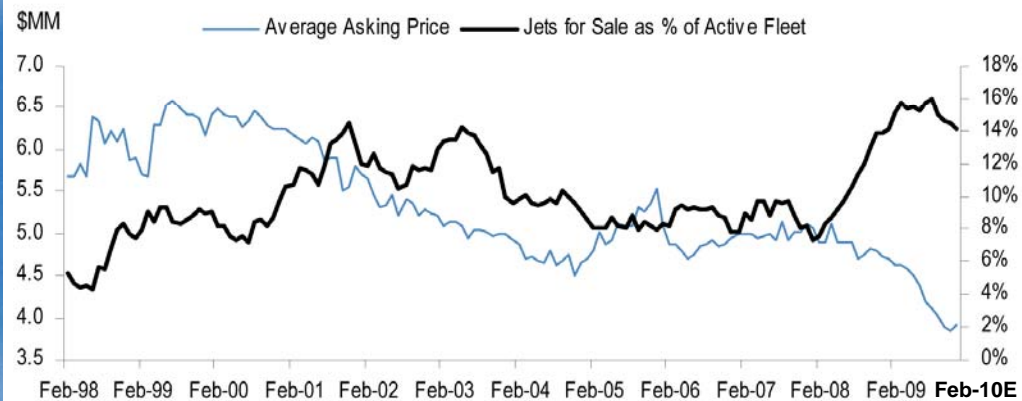
Dassault and Hawker Beechcraft

Figure 26: Dassault



Source: Jetnet and J.P. Morgan estimates.

Figure 27: Hawker Beechcraft



Source: Jetnet and J.P. Morgan estimates.



A Closer Look: Heavy Jets

- Used jet inventories decreased 60bps to 10.9% from November to December
 - Levels have decreased 180bps from the July peak of 12.7%
- Used asking price increased 0.1% to 22.1 million from November to December
 - Asking price down 24.2% y/y)



Heavy Jets: Closer Look

G500/G550/V

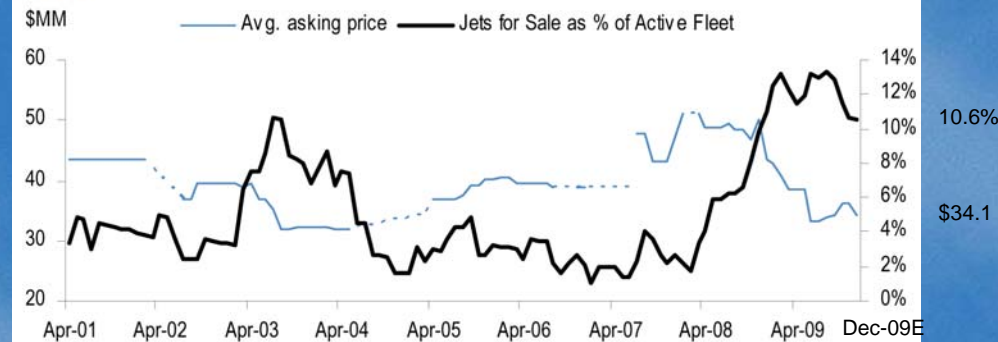
Figure 36



Source: JetNet, J.P. Morgan estimates.

Global 5000/Express/Express XRS

Figure 37



Source: JetNet, J.P. Morgan estimates.



Heavy Jets: Closer Look cont...

Falcon 900/900B/900C/900DX/900EX

Figure 38



Source: JetNet, J.P. Morgan estimates.

G300/G350/G400/G450/IV/IVSP

Figure 39



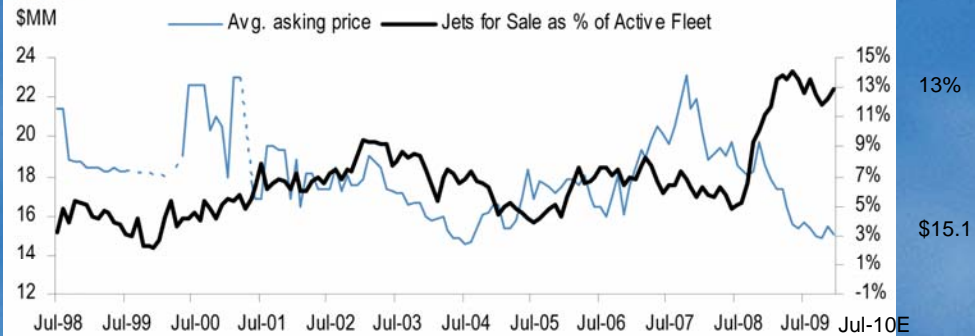
Source: JetNet, J.P. Morgan estimates.



Heavy Jets: Closer Look cont...

Challenger 601-3R/604/605

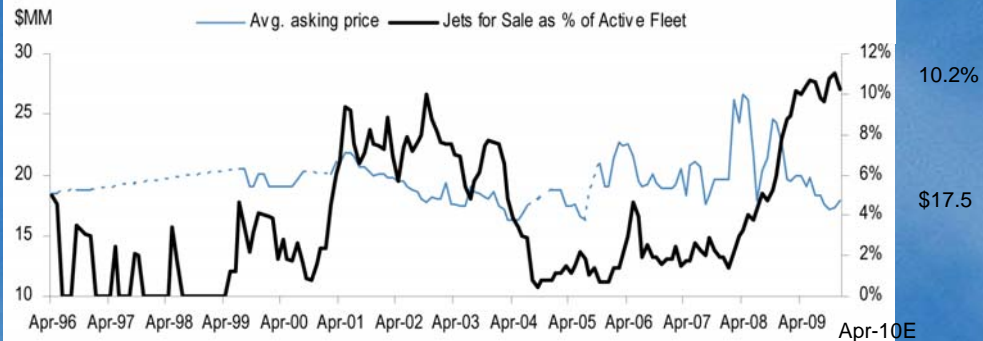
Figure 40



Source: JetNet, J.P. Morgan estimates.

Falcon 2000/2000EX

Figure 41



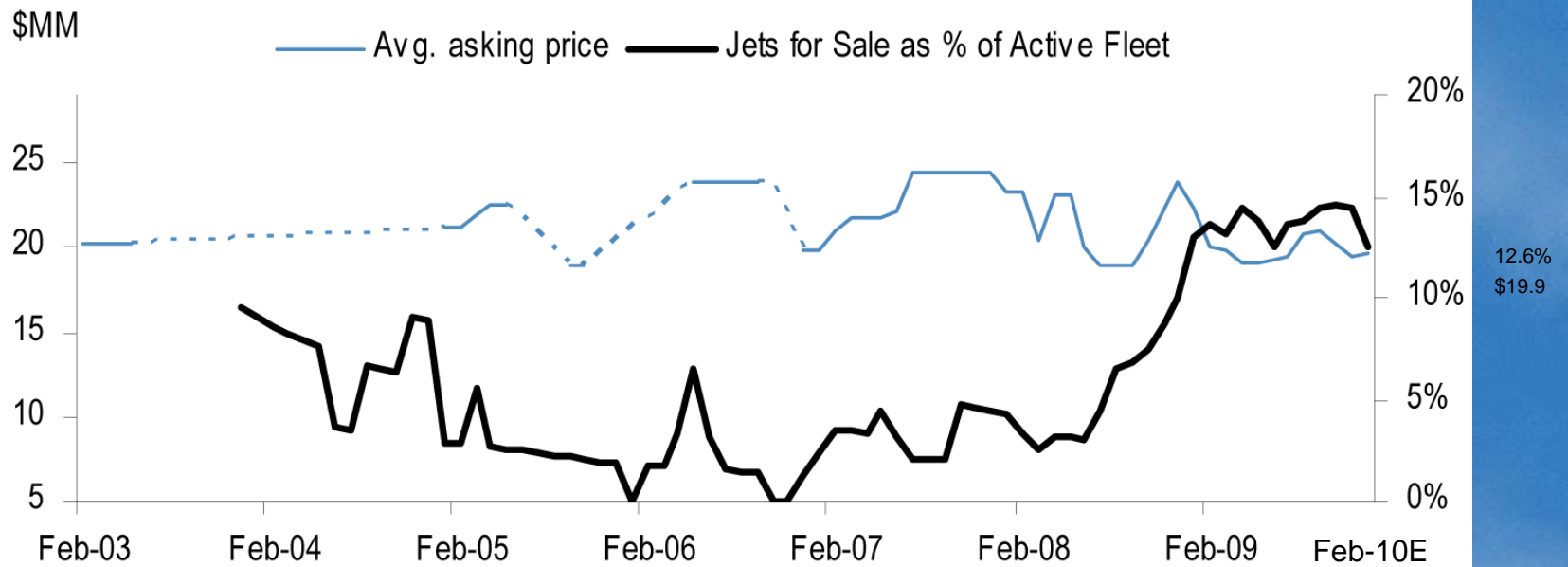
Source: JetNet, J.P. Morgan estimates.



Heavy Jets: Closer Look cont...

Legacy 600

Figure 42



Source: JetNet, J.P. Morgan estimates.





Federal Excise Tax Tips for the Unwary

Overview

Most Flights are Taxable

- Non Commercial flights are subject to excise taxes on aviation gasoline and jet fuel.
- Commercial flights are subject to a smaller excise tax on aviation gasoline and jet fuel, plus excise taxes imposed on amounts paid for the transportation of persons and property by air.



Overview

- The FAA and the IRS do not apply the same standard in determining whether a flight operation is commercial or non commercial.
- The IRS is not bound by a determination of the FAA regarding the commercial or non commercial nature of any flight operation.



Overview

FAA Commercial v. Non Commercial Determination

- Generally, a flight is commercial if the party who exercises *Operational Control* receives any compensation (cash or non-cash) for the provision of an air transportation service to another party.
- *Operational Control* is defined in FAR 1.1 as the exercise of authority over initiating, conducting or terminating a flight.



Overview

IRS Commercial v. Non Commercial Determination

- *Non commercial aviation* is defined as any use of an aircraft, other than use in a business of transporting persons or property for compensation or hire by air.
- *Commercial aviation* is defined as any use of an aircraft other than in *non commercial aviation*.

A flight is considered commercial aviation if the party who exercises Possession, Command and Control is providing transportation of persons or property for compensation or hire.



Overview

- ➔ Part 135 Operations. Operations conducted under Parts 135 of the FAR are generally considered commercial by both the FAA and the IRS (unless a specific exemption applies).
- ➔ Part 91 Operations. Operations conducted under Part 91 of the FAR are considered non commercial by the FAA, *but could be considered commercial by the IRS.*



Overview

→ Examples of Part 91 operations considered *non commercial* by the FAA, but *commercial* by the IRS include:

- Carriage of Candidates in Federal Elections
- Demonstration, Time Sharing, and Interchange Flights
- Fractional Programs (hourly rates are subject to tax, but the law is ambiguous as to whether monthly fees are subject to tax)
- Any reimbursements from shareholders, members, partners, directors, employees, etc., to a corporation, LLC, partnership or other business entity generally, including for personal use
 - Includes reimbursements or capital contributions to a special purpose entity to cover the aircraft budget (discussed in greater detail later)



Commercial Air Transportation Taxes

Base Rates for Domestic Flights.

- Passengers: 7.5%
- Property 6.25%

Segment Fees for Domestic Flights

- Currently \$3.50 (subject to increase annually) per person for each segment of taxable transportation, excluding any segment that begins or ends at a designated *rural airport*



Commercial Air Transportation Taxes

➔ Rates for International Flights

- Currently \$15.40 (subject to increase annually) per person on international flights beginning or ending in the United States.

➔ *The 7.5% and 6.25% Base Rates do not apply to international flights.*



Jet Fuel and Aviation Gasoline Tax Rates

Non Commercial Operations

- Jet Fuel: 21.9 cents per gallon
- Aviation Gasoline; 19.4 cents per gallon

Commercial Operations

- Jet Fuel: 4.4 cents per gallon
- Aviation Gasoline; 4.4 cents per gallon

If tax is paid "at the pump" at the non commercial rates, the purchaser is entitled to a claim a refund or credit of the 17.5 cents per gallon difference between the non commercial and commercial rates for jet fuel, or the 15 cents per gallon difference between the non commercial and commercial rates for aviation gasoline.



Commercial Air Transportation Taxes

Charges Included in the Tax Base.

- All flight time, including ferry time
- Waiting time
- Landing Fees
- FBO handling fees
- Crew expenses, including hotels, rental cars, and meal
- Any other expense incurred in the movement of the aircraft



Commercial Air Transportation Taxes

Charges Excludable from the Tax Base.

→ The following charges may be excluded from the tax base *if separately stated on the invoice*:

- Catering
- Passenger ground transportation
- Other services provided for the convenience of the passenger if not related to the air transportation



Commercial Air Transportation Taxes - Use of Special Purpose Entities

- ➔ A common operations planning error is to form a special purpose entity (SPE) for the sole purpose of owning and operating an aircraft on behalf of a parent company, affiliate, shareholder, etc. According to the IRS, if the SPE has possession, command and control of the aircraft, all funds paid into the SPE (including capital contributions) are compensation for air transportation, and as such the air transportation is commercial and is subject to excise tax
- ➔ Caveat: Prior to 2008, the foregoing rule did not apply to disregarded entities (i.e., SMLLC's and QSSS's); however . . .



Commercial Air Transportation Taxes - Use of Special Purpose Entities Cont.

→ . . . the IRS recently amended its regulations relating to disregarded entities to comply with the Self-Employment Contributions Act. Under the revised regulations, effective January 1, 2008, it is possible that an entity that is disregarded for federal income tax purposes is NOT disregarded for excise tax purposes, and must collect and remit taxes on air transportation provided to its parent, affiliates, shareholders, etc.

- Prop & Temp Treas Reg 301.7701-2T(c)(2)(v)(B)
- TD 9462 (Sept 14, 2009)
- Preamble to Proposed Regs [REG-116614-08] 74 Fed. Reg. 46,957



Use of a Management Company

- ➔ An aircraft management company's business purpose is to manage the operations of an aircraft
 - The aircraft management company will enter into an agreement (Management Agreement) to manage flight operations and maintain the owner's aircraft
- ➔ An aircraft management company may also act as a Charter Company and place the aircraft into a fleet of aircraft available for charter to unrelated third parties



Management Company Payments

→ Air Transportation Excise Tax - Audit Technique Guide

- Publication Date: April, 2008
- <http://www.irs.gov/businesses/small/article/0,,id=186838,00.html>
- Wet Lease Considerations
- Dry Lease Considerations



Wet Lease to Aircraft Management Company from IRS GuideBook

- “With a wet lease, the aircraft owner pays for all costs attributable to the operation of the aircraft, including the pilot and crew salaries, fuel, insurance, and fees incurred when the aircraft is used
 - The aircraft owner retains the right to direct the pilots when and where to fly as well as to be able to replace a pilot certified to fly the aircraft
 - Therefore, the aircraft owner retains possession, command, and control of the aircraft
- The aircraft management company in this case acts as an agent of the corporation. In this capacity, the aircraft management company is not required to collect the air transportation tax on amounts it receives from the aircraft owner (Cite: Rev. Rul. 58-215, 1958-1 C.B. 439; Rev. Rul. 60-311, 1960-2 C.B. 341)
- The aircraft owner is responsible for collecting and depositing the tax under section 4261 on amounts paid for any use by the management company or on the amounts paid for unrelated third party flights.
- When the aircraft owner uses its own aircraft, no tax is due”



Dry Lease to Aircraft Management Company from IRS GuideBook

- “Under a dry lease, the aircraft owner is leasing the aircraft itself and the management company is providing the pilot. The management company will also coordinate all scheduling of the aircraft
 - In this case, possession, command, and control of the aircraft has been transferred from the aircraft owner to the management company
 - The management company now becomes responsible for collecting and remitting the air transportation excise taxes under sections 4261 and 4271 on amounts paid for the use of the aircraft
- Under a dry lease, since possession, command, and control has been relinquished by the aircraft owner, amounts it pays for its own flights are taxable
 - In other words, the aircraft owner’s flights are treated the same as flights of unrelated third parties
 - In this case, the affiliated group exemption from the air transportation tax under section 4282 would not apply because the management company has possession, command, and control.
 - The management company is basically wet leasing the aircraft back to the aircraft’s owner
 - The tax under section 4261 is calculated on all amounts paid to the management company by the aircraft owner”



Where the IRS Is Wrong

- The description of a “wet lease” is an extremely rare contractual arrangement between an aircraft owner and a management company
- There are really 2 Functions, only one is based on a lease
 - Management Services
 - Agency relationship, not a lease based relationship
 - Charter
 - In the context of giving access to the aircraft for charter, the owning entity must lease the aircraft to the Management Company in order to transfer possession and control of the aircraft for FAA purposes
 - The aircraft owning entity may also employ the crew
 - The lease arrangement in this situation would typically be prepared as a “non-exclusive” arrangement, reserving rights to the owner to use the aircraft as well



Where the IRS Is Wrong Cont...

- Under the IRS definition of “dry lease” the IRS states that the Management Company employs the crew
- The IRS is focusing on who has employment control of the crew and all decisions regarding management of the aircraft for the owner’s use under Part 91



Planning Opportunities

- ➔ Planning to minimize the risk of an adverse determination by the IRS
 - Insure that you as the owner, maintain rights to unilaterally modify anything which you are unhappy with within the Management Agreement (as it is only an agency relationship)
 - Maintain agency relationship
 - Never convey possession or control of the aircraft to the Management Company (for managing aspects)
 - Even if the Management Company employs the crew for charter usage, you must be able to fire the crew at your sole discretion
 - Retain the right to cancel a scheduled charter flight (with minimal notice and a likely economic forfeiture)



Planning Opportunities – Triangle Structure

- Segregate the Charter Agreement from the Management Agreement
 - Rights conveyed under the Management Agreement are contracted with the operating business
 - Rights conveyed under the Charter Agreement are contracted with the aircraft owning entity





Closing Remarks



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